

## Message Text

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ACTION EA-12

INFO OCT-01 EUR-12 ISO-00 AID-05 CEA-01 CIAE-00  
COME-00 EB-08 FRB-03 INR-10 IO-13 NEA-10 NSAE-00  
ICA-11 OPIC-03 SP-02 TRSE-00 LAB-04 SIL-01  
AGRE-00 OMB-01 SS-15 NSC-05 PA-01 /118 W  
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R 250859Z APR 78  
FM AMEMBASSY TOKYO  
TO SECSTATE WASHDC 7376  
INFO AMEMBASSY BERN  
AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
AMEMBASSY LONDON  
AMEMBASSY OTTAWA  
AMEMBASSY PARIS  
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PASS TREASURY AND FEDERAL RESERVE BOARD

USEEC

USOECN ALSO FOR EMBASSY

E.O. 11652: N/A  
TAGS: EFIN, JA  
SUBJECT: BALLES VISIT: FOREIGN BRANCH BANKING IN JAPAN

1. SUMMARY: ONE MAIN SUBJECT DURING VISIT HERE APRIL  
12-19 OF JOHN BALLES, PRESIDENT OF FEDERAL RESERVE BANK OF  
SAN FRANCISCO, AND HARRY GREEN, DIRECTOR OF BANKING HOLD-  
ING COMPANY REGULATION, FRBSF, WAS FUTURE ROLE OF FOREIGN  
BRANCH BANKS IN JAPAN. IN MEETINGS WITH BANK OF JAPAN  
(BOJ) AND MINISTRY OF FINANCE (MOF) OFFICIALS, BALLES  
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POINTED NOT ONLY TO CURRENT, POSSIBLY CYCLICAL, PROBLEMS  
OF FOREIGN BRANCHES OPERATING IN JAPAN BUT ALSO TO DEEPER  
QUESTIONS OF THEIR ROLE IN A FINANCIAL SYSTEM WHICH HAS  
BECOME LESS DEPENDENT ON FOREIGN CAPITAL, HAS SHOWN  
INTEREST IN BECOMING A CAPITAL EXPORTER, AND IS SHIFTING  
INCREASINGLY FROM FOREIGN CURRENCY TO YEN FINANCING.  
BALLES ALSO POINTED TO POTENTIAL RISKS FROM PERCEIVED LACK

OF RECIPROCITY BETWEEN WHAT U.S. BRANCHES OPERATING IN JAPAN COULD DO AND WHAT JAPANESE BANKS OPERATING IN THE U.S. COULD DO, PARTICULARLY CITING CALIFORNIA. JAPANESE AUTHORITIES SHOWED GENERAL UNDERSTANDING OF AND SYMPATHY WITH CURRENT SITUATION OF FOREIGN BRANCHES AND WILLINGNESS TO CONSIDER MITIGATING STEPS; BUT IT WAS LESS CLEAR THAT THEY HAD FACED UP TO, OR COULD DEAL SATISFACTORILY WITH, QUESTIONS OF LONGER-TERM ROLE OF FOREIGN BRANCHES IN JAPAN, OR HOW TO PROVIDE RECIPROCAL TREATMENT, PARTICULARLY FOR MORE LIBERAL U.S. STATES. BALLE WILL BE REPORTING HIS CONCLUSIONS TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. EMBASSY BELIEVES THAT THE TIME IS RIPE FOR CAREFUL CONSIDERATION OF THESE PROBLEMS BY INTERESTED WASHINGTON AGENCIES. END SUMMARY.

2. AS PART OF CONTINUING SERIES OF VISITS TO ASIAN COUNTRIES WHERE U.S. BANKS OPERATE EXTENSIVELY, JOHN BALLE, PRESIDENT FEDERAL RESERVE BANK OF SAN FRANCISCO, AND HARRY GREEN, DIRECTOR OF BANK HOLDING COMPANY REGULATION, FRBSF, VISITED TOKYO APRIL 12-19. THEY MET WITH GOVERNOR MORINAGA AND OTHER OFFICIALS OF THE BOJ, DIRECTOR GENERAL DAN, INTERNATIONAL FINANCE BUREAU, AND DEPUTY DIRECTOR GENERAL WATANABE, BANKING BUREAU, AT THE MOF, AS WELL AS JOINTLY AND PRIVATELY WITH THE U.S. AND JAPANESE BANKING COMMUNITY. IN THEIR DISCUSSIONS, THEY EXPLAINED PROPOSED CLOSER EXAMINATION BY U.S. AUTHORITIES LIMITED OFFICIAL USE

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OF OVERSEAS LENDING BY U.S. BANKS WHICH IS ENVISAGED AND EXPLORED PROBLEMS JAPANESE SUPERVISORY AUTHORITIES MIGHT HAVE WITH U.S. BRANCH BANKS OPERATING IN JAPAN, AS WELL AS REPORTING ON STATUS OF INTERNATIONAL BANKING ACT IN THE U.S. CONGRESS. HOWEVER, A SUBSTANTIAL PORTION OF THEIR CONVERSATIONS WAS DEVOTED TO CURRENT AND POTENTIAL FUTURE PROBLEMS OF U.S. BRANCH BANKS OPERATING IN JAPAN.

3. ON LATTER SUBJECT, BALLE REFERRED TO CURRENT CONCERNS OF U.S. BRANCH BANKS IN JAPAN ABOUT THEIR DETERIORATING POSITION, AS REFLECTED IN THEIR EARNINGS POSITION. ALTHOUGH RECOGNIZED THAT CYCLICAL FACTORS COULD ALSO BE PLAYING A ROLE, HE FOCUSED ATTENTION ON BROADER QUESTION OF LONG-TERM ROLE OF FOREIGN BRANCHES IN A FINANCIAL SYSTEM BECOMING LESS DEPENDENT ON CAPITAL IMPORTS, INTERESTED IN BECOMING A CAPITAL EXPORTER, AND SHIFTING INCREASINGLY FROM FOREIGN CURRENCY TO YEN FINANCING. HE ALSO REFERRED TO THE GROWING FEELING IN THE U.S. THAT U.S. BANKS DID NOT HAVE THE OPPORTUNITY TO DO BUSINESS IN JAPAN COMPARABLE TO THE OPPORTUNITIES AFFORDED JAPANESE BANKS TO DO BUSINESS IN THE U.S. MAKING CLEAR HE MEANT TO POINT OUT A RISK AND NOT ISSUE A THREAT, HE RECALLED THAT

SEVERAL YEARS AGO LEGISLATION WHICH WOULD HAVE EXACTED  
STRICT RECIPROCITY FROM FOREIGN GOVTS HAD BEEN  
DEFEATED IN CALIFORNIA, AND EXPRESSED THE VIEW THAT  
NEITHER HE NOR THE SUPERINTENDENT OF CALIFORNIA BANKS WAS  
CONFIDENT THAT SUCH LEGISLATION COULD BE BEATEN BACK IF  
OFFERED AGAIN TODAY. IN TERMS OF SPECIFICS WHICH MIGHT  
ALLEVIATE THE POSITION OF FOREIGN BRANCHES OPERATING IN  
JAPAN AND THE PROBLEM OF RECIPROCITY, BALLES MENTIONED  
INTER ALIA ISSUE OF SHORT-TERM YEN CD'S, INCREASE IN BOJ  
SWAP LINES AT LEAST TO COMPENSATE FOR CURRENCY CHANGES,  
RELAXATION OF RESTRICTIONS ON LENDING BY JAPANESE BANKS TO  
U.S. BRANCHES, AND A MORE LIBERAL POLICY TOWARD BRANCHING

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R 250859Z APR 78  
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AND PURCHASE OF JAPANESE BANKS IN JAPAN.

4. THE JAPANESE AUTHORITIES DISPLAYED GENERAL UNDERSTAND-  
ING OF AND SYMPATHY WITH THE CURRENT SITUATION OF FOREIGN  
BANKS IN JAPAN AND EXPRESSED WILLINGNESS TO TAKE MITIGAT-  
ING STEPS. (THE BOJ HAD ALREADY PREPARED AN EXPLANATION  
OF ITS POLICIES TOWARD FOREIGN BRANCHES IN JAPAN, WHICH IS  
BEING POUCHED TO INTERESTED WASHINGTON AGENCIES.) THEY  
EXPRESSED WILLINGNESS TO CONSIDER INCREASES IN FOREIGN  
BRANCH SWAP LINES ONCE MORE STABLE CONDITIONS WERE RE-

STORED TO THE FOREIGN EXCHANGE MARKETS AND SUCH ACTION WOULD NOT ADD TO TENSIONS. THEY ADVISED THAT RESTRICTIONS ON LENDING BY JAPANESE BANKS TO FOREIGN BRANCHES HAD ALREADY BEEN LIFTED. THEY ALSO INDICATED THAT, SINCE APPLICATIONS BY FOREIGN BANKS TO ESTABLISH NEW FIRST BRANCHES HAD FALLEN OFF, THEY WOULD BE PREPARED TO CON-  
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SIDER APPLICATIONS FROM EXISTING FOREIGN BANK BRANCHES TO ESTABLISH SOME ADDITIONAL OFFICES IN JAPAN (ALTHOUGH IT WAS INTERESTING TO NOTE ONE OFFICIAL SAID "ASSUMING NO RESPONSIBILITY AS TO THEIR PROFITABILITY"). SOME FLEXIBILITY WAS ALSO DISPLAYED WITH RESPECT TO FOREIGN PURCHASES INTO JAPANESE BANK BRANCHES (BUT THIS STATEMENT MAY REFLECT MISUNDERSTANDING OF TECHNICAL TERMS). MOF BANKING BUREAU OFFICIALS ALSO, AS A LONG-RUN PROPOSITION, APPEARED TO VIEW FAVORABLY INTRODUCTION OF CD'S; BUT THEY CAUTIONED THAT THE NECESSARY CONSENSUS TO INTRODUCE THIS INSTRUMENT HAD NOT BEEN REACHED (AND THERE ARE OBJECTORS, E.G. SECURITIES COMPANIES). THEY ALSO INDICATED THAT IT WAS STILL NOT CLEAR AS A LEGAL MATTER WHETHER CD'S WERE A DEPOSIT INSTRUMENT, AND COULD BE INTRODUCED ADMINISTRATIVELY, OR WHETHER CD'S WERE A DEBENTURE AND LEGISLATION WOULD BE REQUIRED. ALTHOUGH NOT MENTIONED TO MR. BALLE, THERE ARE ALSO UNSUBSTANTIATED PRESS REPORTS THAT THE MOF INTENDS TO RELAX RESTRICTIONS ON IMPACT LOANS TO ALLOW JAPANESE EXPORTERS TO HEDGE THEIR FOREIGN CURRENCY OPERATIONS.

5. ON THE QUESTION OF THE LONG-TERM ROLE OF FOREIGN BRANCHES IN JAPAN, AND, LESS EXPLICITLY, ON THE GENERAL PROBLEM OF HOW TO ACHIEVE RECIPROCITY, THE JAPANESE AUTHORITIES SEEMED EITHER TO HAVE LESS CLEARLY FACED UP TO THE QUESTION OR TO BE LESS CERTAIN AS TO HOW THEY COULD DEAL SATISFACTORILY WITH IT. IN THIS CONNECTION THEY INDICATED A WILLINGNESS TO ADDRESS THE PROBLEMS, AND REFERRED TO THE REVIEW OF THE JAPANESE FINANCIAL SYSTEM WHICH HAS BEEN GOING ON FOR THE PAST COUPLE OF YEARS. THEY SAID THEY HOPED POSSIBLY TO COMPLETE THEIR REVIEW BY THE END OF THIS YEAR. THEY INDICATED THAT THIS WOULD BE FOLLOWED BY PREPARATION OF LEGISLATION AND THE LEGISLATIVE  
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PROCESS, WHICH COULD MEAN THAT CHANGES WOULD BE FOUR OR FIVE YEARS DOWN THE ROAD.

6. MR. BALLE WILL BE REPORTING HIS CONCLUSIONS TO THE FRB. IT SEEMS TO THE EMBASSY THAT HIS VISIT HAS BROUGHT WELCOME ATTENTION TO THE NEED FOR CAREFUL CONSIDERATION OF THE ROLE OF FOREIGN, AND SPECIFICALLY U.S., BRANCH BANKS IN JAPAN, AND TO THE ROLE OF THE USG IN SUPPORTING THAT ROLE.

7. OUR PRELIMINARY THOUGHTS ARE THAT THERE MAY BE THREE SEPARABLE IF RELATED QUESTIONS: (A) THE PROBLEM OF THE FUTURE OF U.S., ALONG WITH OTHER FOREIGN, BRANCH BANKS IN JAPAN AS JAPAN DECREASES ITS DEPENDENCE ON THE FOREIGN CURRENCY FINANCING WHICH HAS FIGURED IMPORTANTLY IN THEIR OPERATIONS HERE; (B) THE QUESTION OF WHETHER THERE IS DISCRIMINATION IN THE TREATMENT OF U.S. BRANCH BANKS OPERATING IN JAPAN, AND (C) THE QUESTION OF ACHIEVING RECIPROCITY IN U.S.-JAPANESE BANKING RELATIONSHIPS.

8. THE BROAD QUESTION OF THE ROLE OF U.S. BANKS OPERATING IN JAPAN SEEMS TO US A PRIOR QUESTION. SHOULD THE U.S. BRANCHES CONTINUE TO PLAY A FAIRLY SPECIALIZED ROLE OR SHOULD THEY SEEK UNFETTERED COMPETITION? COULD THEY COMPETE SUCCESSFULLY FOR BUSINESS IN JAPAN IF BOTH THE LIMITS ON THEIR OPERATIONS AND THE PRIVILEGES THEY ENJOY WERE ELIMINATED? IF FULL COMPETITION WERE THE OPTION, TO WHAT EXTENT COULD WE OPPOSE MEASURES FALLING HEAVILY ON FOREIGN BRANCHES WHICH RETAINED THEIR INTERNATIONAL BUSINESS ORIENTATION? (E.G. RESERVE REQUIREMENTS ON FOREIGN LIABILITIES). ANOTHER RELATED QUESTION IS THE DEGREE TO WHICH IT IS REALISTIC EITHER TO EXPECT LIBERALIZATION OF JAPANESE BANKING PRACTICES FOR FOREIGN BRANCHES ALONE, OR TO SEEK LIBERALIZATION OF THE ENTIRE JAPANESE BANKING

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SYSTEM SUCH AS ISSUE OF BANK DEBENTURES BASICALLY TO ACCOMMODATE FOREIGN BANKS. ANSWERS TO THESE QUESTIONS SHOULD BE SOUGHT BEFORE METHODS OF APPROACH ARE CONSIDERED. AN IMPORTANT ELEMENT IN REACHING CONCLUSIONS WILL BE TO SYNTHESIZE THE SOMETIMES DISPARATE VIEWS OF AMERICAN BANKS. BALLES WAS GIVEN A LIST OF PROBLEMS BY APCAC (ALSO BEING POUCHED) ON WHICH HE IS INVITING VIEWS OF INDIVIDUAL U.S. BANKS IN JAPAN; DISPARATE RESPONSES CAN BE EXPECTED.

9. IT SHOULD ALSO BE KEPT IN MIND THAT IN MANY CASES U.S. BANKS MAY WISH TO TRY THEMSELVES TO RESOLVE PROBLEMS AMICABLY WITH THE HOST GOVERNMENT. IN OTHERS THEY MAY SEEK USG HELP. (MANY U.S. BANKS HAVE SHOWN RELUCTANCE TO UNITE AMONG THEMSELVES TO PRESS THEIR CASES ON GOJ.)

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10. IT SEEMS TO US FUNDAMENTAL TO CONSIDER WHETHER THERE IS DISCRIMINATION AGAINST U.S. BRANCHES OPERATING IN JAPAN, ALTHOUGH THE DIFFERENCES IN THE TREATMENT PROVIDED FOREIGN BRANCHES IN THE U.S. BY THE VARIOUS STATES AND AT THE NATIONAL LEVEL MAY RAISE QUESTIONS AS TO OUR ABILITY TO PROVIDE NON-DISCRIMINATORY TREATMENT OURSELVES. WE ARE NOT IN ANY CASE AT THIS STAGE INCLINED TO BELIEVE THAT DISCRIMINATION POSES MAJOR PROBLEMS, BUT EMBASSY WILL SHORTLY BE FORWARDING A MORE CAREFUL EVALUATION OF THE DEGREE TO WHICH SUCH DISCRIMINATION EXISTS.

11. WHILE A HARDER LOOK WOULD CERTAINLY BE DESIRABLE, IT DOES SEEM RATHER CLEAR ON AVAILABLE EVIDENCE THAT THE U.S. HAS NOT BEEN SUCCESSFUL IN GAINING RECIPROCITY FOR U.S. BRANCH OPERATIONS IN JAPAN, AT LEAST INsofar AS SOME STATES ARE CONCERNED AND PROBABLY ALSO AT THE NATIONAL LEVEL. IT MAY WELL BE THAT JAPAN WILL NOT IN THE FORESEEABLE FUTURE BE PREPARED, OR EVEN ABLE, TO GRANT FULL RECIPROCITY, BECAUSE OF DIFFERENCES BETWEEN OUR TWO FINANCIAL SYSTEMS. WE HAVE BEEN TOLD THAT THE LARGE AMERICAN BRANCHES HERE IN JAPAN HAVE COMMISSIONED A REVIEW OF THEIR SITUATION HERE BY THE INTERNATIONAL BUSINESS INSTITUTE, AND THEY MAY BE WILLING TO SHARE THIS STUDY

WITH THE USG. IT WOULD SEEM DESIRABLE TO OBTAIN A MORE GENERAL PICTURE OF THE PRACTICES OF THE 50 U.S. STATES TOWARD ENTRY AND OPERATION OF FOREIGN BRANCHES. THERE ARE, FROM THE FEDERAL GOVT POINT OF VIEW, DOUBTLESS SUBSTANTIAL DIFFERENCES IN THE LIBERALITY OF THE VARIOUS STATES WHICH WOULD HAVE TO BE TAKEN INTO ACCOUNT IN ARRIVING AT A JUDGMENT AS TO WHAT COULD APPROPRIATELY BE ASKED OF JAPAN ON GROUNDS OF RECIPROCITY. HOWEVER, THERE WILL REMAIN THE QUESTION OF HOW, EVEN GIVEN DIFFERENCES AMONG STATES, TO ACHIEVE AND MAINTAIN OVERALL RECIPROCITY LIMITED OFFICIAL USE

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BETWEEN THE U.S. AND JAPAN IN THE BANKING SPHERE. IN ANY EVENT, IT WOULD SEEM USEFUL TO TRY TO PULL TOGETHER BANKING STATISTICS WHICH PROVIDE A MEASURE OF TRENDS IN RECIPROCITY AT THE NATIONAL LEVEL.

12. EMBASSY IS NOT AT ALL CLEAR AS TO HOW ALL THE FOREGOING CONSIDERATIONS CAN BE SORTED OUT. THE COURSE OF EVENTS WILL BE DETERMINED NOT ONLY BY THE PROGRESS OF THE INTERNATIONAL BANKING ACT BUT ALSO BY OTHER PROGRESS TOWARD A NATIONAL POLICY ON BANKING. THE IMPLICATIONS FOR SEEKING BOTH NON-DISCRIMINATORY TREATMENT AND RECIPROCITY GIVEN THE DIVERSE TREATMENT OF FOREIGN, AND SPECIFICALLY JAPANESE, BANKS IN THE U.S. AS A RESULT OF THE DIVISION OF RESPONSIBILITY BETWEEN THE FEDERAL GOVT AND THE STATES, ARE PROBLEMS WE HAPPILY LEAVE TO WASHINGTON. FROM THE JAPANESE PERSPECTIVE, WE SUGGEST CONSIDERATION BE GIVEN TO FORMULATING AN INPUT INTO THE ONGOING CONSIDERATION HERE OF THE FUTURE OF THE JAPANESE FINANCIAL SYSTEM. IT SEEMS TO US THAT THE GOJ IS PREPARED, IF WE AND THE U.S. BANKS SO WISH, TO RECONSIDER BILATERALLY THE ROLE OF U.S. BANKS IN JAPAN, AND A CONSIDERED EXPRESSION OF OUR VIEWS WOULD PROBABLY BE WELL RECEIVED. WE RECOGNIZE, HOWEVER, THAT FINAL JUDGMENT ON SUBMITTING SUCH VIEWS WOULD HAVE TO BE RESERVED UNTIL THE IMPACT OF DOING SO BOTH ON THE AMERICAN BANKS OPERATING HERE AND ON BROADER QUESTIONS OF U.S.-JAPAN FINANCIAL RELATIONS COULD BE JUDGED. IN PARTICULAR, WE WOULD NOT WANT TO APPEAR TO BE SUGGESTING INTERFERENCE IN ESSENTIALLY DOMESTIC FINANCIAL QUESTIONS -- AND IT REMAINS TO BE SEEN HOW MUCH COULD BE SAID WITHOUT SO DOING. MANSFIELD

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## Message Attributes

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**To:** STATE USEEC MULTIPLE  
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